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8 **BEFORE THE INSURANCE COMMISSIONER**  
9 **OF THE STATE OF CALIFORNIA**  
10

11 In the Matter of the Private Passenger Rate  
12 Application of the California Automobile  
13 Assigned Risk Plan for the California Low  
14 Cost Automobile Insurance Pilot Program,

15 Applicant.

FILE NO. RH05042665

DECISION AND ORDER

16 The 2005 rate application of the California Automobile Assigned Risk Plan (CAARP) for the  
17 California Low Cost Automobile Insurance Pilot Program came on for public hearing on May 31,  
18 2005. The public comment period was extended to June 17, 2005 to permit comment on  
19 CAARP's revised rate recommendation to increase rates by an overall 12.3 percent and maintain  
20 the surcharge for certain drivers. Written testimony and exhibits were received and statements,  
21 arguments and public comments were heard.

22 **BACKGROUND**  
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24 In 2002, the legislature reduced the statutory premiums for a low-cost automobile  
25 insurance policy to \$347 for Los Angeles County and \$314 for the City and County of San  
26 Francisco, effective March 1, 2003. (Statutes 2002, chapter 742.) The legislation also mandated  
27 that uninsured motorists and medical payments coverages be made available, at additional cost.  
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1 Premiums for these coverages have been established through the public hearing process.

2 Current premiums for uninsured motorists bodily injury coverage are \$64 per vehicle in  
3 Los Angeles County and \$39 per vehicle in the City and County of San Francisco. For medical  
4 payments coverage, current premiums are \$26 per vehicle in Los Angeles County and \$24 per  
5 vehicle in the City and County of San Francisco.  
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7 Insurance Code Sections 11629.72(c) and 11629.92(c) provide that, annually, CAARP  
8 shall submit to the Commissioner a proposed rate and surcharge for approval. In its 2004  
9 proposal, CAARP recommended no change to premiums or the surcharge percentage, which  
10 recommendation was adopted by the Commissioner on June 15, 2004.

11 CAARP submitted its statutorily-mandated rate proposal for 2005, which was received by  
12 the Commissioner on or about January 7, 2005. In its proposal, CAARP recommended an overall  
13 rate increase of 19.3 percent and no change to the 25 percent surcharge for certain drivers.  
14 Subsequently, based on updated trend data through December 31, 2004, CAARP revised its rate  
15 recommendation and proposed an overall increase of 12.3 percent with no change to the  
16 surcharge. A copy of CAARP's revised recommendation and supplemental response are  
17 available for public review in the rulemaking file.  
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19 At the public hearing, Douglas Heller, Executive Director of the Foundation for Taxpayer  
20 and Consumer Rights, (FTCR),<sup>1</sup> recommended an overall increase of 1.2 percent, based on an  
21 analysis prepared by its consulting actuary, AIS Risk Consultants (AIS), a copy of which is  
22 available for public review in the rulemaking file. Mr. Heller commented that the AIS analysis  
23 differs from that of CAARP in four key areas – loss development, loss trends, underwriting  
24 expenses, and credibility. In addition, Mr. Heller expressed support for the efforts of the  
25 Department of Insurance in raising public awareness of the existence of the Low Cost  
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1 The FTCT petitioned to participate in this proceeding May 24, 2005, which was granted June 10, 2005.

1 Automobile Insurance program. In addition, Mr. Heller expressed support for the efforts of the  
2 Department of Insurance in raising public awareness of the existence of the Low Cost  
3 Automobile Insurance program.

4 In written comments, the consumer representatives on the CAARP Advisory Committee  
5 also expressed support for the Department's outreach efforts. They commented on the important  
6 benefits of the program to working families in California and encouraged the expansion of the  
7 program to all counties in the state. They indicated that if actuarial data supports an increase,  
8 they would support an increase of no more than 1.2 percent.

9 The statutes specify that rates shall be sufficient to cover losses and expenses incurred  
10 under policies issued under the pilot program. In assessing loss reserves, the Commissioner shall  
11 only allow loss reserves estimated from actual losses in the pilot programs or comparable data by  
12 a licensed statistical agent, adjusted to reflect coverage provided by the pilot programs. Rates  
13 shall be set so as to result in no subsidy of the program or subsidy of policyholders in one pilot  
14 program by policyholders in the other pilot program. In accordance with these rate-setting  
15 standards, on April 8, 2005, the Commissioner issued a Notice of Proposed Action and Notice of  
16 Public Hearing and Initial Statement of Reasons to consider CAARP's 2005 rate  
17 recommendation.

## 21 **DECISION**

22 After carefully considering all comments and written testimony and exhibits submitted  
23 during the public hearing period, the Commissioner has declined to accept CAARP's  
24 recommendation of an overall increase of 12.3 percent or the AIS suggestion of an overall  
25 increase of 1.2 percent. Based on an independent actuarial analysis, the Department has  
26 determined that an overall rate increase of 2.5 percent, with no change to the current surcharge for  
27 certain drivers, is adequate and consistent with statutory rate-setting standards. The Department  
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has determined indicated rate changes for all coverages, delineated as follows:

	<u>CAARP's Proposal</u>	<u>Department's Indicated Rate Change</u>
Liability	11.2%	2.4%
Uninsured Motorist	17.0%	1.0%
Medical Payment	75.3%	10.0%

#### Loss Trends

AIS criticized CAARP for not using recent data for the trend factors for bodily injury, uninsured motorist and property damage. However, CAARP revised its filing to include lower trend selections based on updated data. Given that trend selections of AIS and CAARP's revised selections produced only minor differences, CAARP's revised selections for bodily injury, uninsured motorist and property damage appear reasonable. For medical payments coverage, however, CAARP utilized the Consumer Price Index for Medical Care (CPI) for severity and assumed zero for frequency. The Department finds that neither of these assumptions is reasonable. It is more reasonable that the lower limits have a capping effect on severity and that frequency tracks with bodily injury. AIS contended that a bodily injury trend factor is more accurate and better reflects both the trend in claim frequency and claim severity. The Commissioner accepts AIS's suggestion and finds that the use of bodily injury trends for medical payments coverage better reflects the loss trend for private passenger automobile injuries than the CPI medical inflation factor utilized by CAARP. Accordingly, this lowers CAARP's overall indication by 0.3 percent.

#### Loss Development

To calculate loss development, CAARP utilized nine months of low cost auto program claims experience averaged with CAARP loss development factors as of 21 months of development. AIS commented that CAARP's loss development factors based on low cost auto

1 data have very low credibility and that the 50% weight assigned by CAARP was too high. In  
2 addition, AIS commented that the factors cause a mismatch between losses and premium because  
3 the ultimate developed losses are for 12 months while the premiums are only for nine months.  
4 CAARP countered that the AIS standard of 10,623 claims for full credibility is too high and a  
5 more reasonable standard is 1,084 claims. Acknowledging that the criticism about a mismatch  
6 was correct, CAARP contended that it addressed the overstatement by averaging low cost auto  
7 factors with CAARP development factors.

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9 The Commissioner agrees with CAARP that, as a practical matter, a full credibility  
10 standard of 10,623 claims is too high. Given that, the Commissioner finds that CAARP's use of a  
11 simple average of low cost auto data and fitted CAARP link ratios is not unreasonable.

12 The Commissioner finds that CAARP's methodology of calculating loss development  
13 from nine months of premium and twelve months of ultimate developed loss overstates the loss  
14 development factors. We reject CAARP's assertion that the averaging somehow corrects for the  
15 acknowledged overstatement. Rather than intended as a correction, it appears to have been  
16 utilized as an informal credibility adjustment. The fact that it lowers the indication in the same  
17 direction as correcting the overstatement is mere chance. To correct this overstatement, the  
18 Commissioner has applied a factor of .75 to the low cost auto factor before averaging, retaining  
19 the averaging as a credibility adjustment. This is the equivalent of CAARP's suggestion to  
20 convert the nine months of low cost auto losses used in the denominator of the link ratio  
21 calculations to an estimated full-year basis. Making no changes to the rest of the calculations  
22 results in 9-ultimate factors of 1.143 for bodily injury and 1.172 for property damage.  
23 Accordingly, this lowers CAARP's overall rate indication by 6.2 percent.

#### 24 Underwriting Expenses

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26 CAARP's initial and revised filings did not document the sources for the selected  
27 underwriting expense provisions. In its supplemental response to AIS's testimony, CAARP  
28 showed the calculation for general and other acquisition expenses and identified the source as

1 A.M. Best's Aggregates and Averages. CAARP used a three-year average of countrywide data,  
2 removing advertising expenses. Not knowing how CAARP calculated its numbers, AIS  
3 calculated expense numbers independently, based on source data from the National Association  
4 of Insurance Commissioner's ("NAIC") Study of Profitability. AIS explained that these numbers  
5 are California specific for taxes, licenses and fees and that other acquisition expenses and general  
6 expenses are allocations of countrywide expenses to California. In its response, CAARP argued  
7 that its expense items and methodologies are unchanged from previously approved  
8 methodologies, but did not state any reason why AIS methodologies should not be used.

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10 Although the differences between CAARP and AIS calculations are small, the Department  
11 finds that the use of source data from NAIC is preferable to CAARP's use of countrywide data  
12 because the NAIC data is more California specific. Accordingly, using the AIS underwriting  
13 expense values, CAARP's overall rate indication is lowered by 1.7 percent.

#### 14 Credibility

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16 CAARP based its methodology solely on Low Cost Automobile Insurance program  
17 claims experience, although acknowledging that the data is not 100 percent credible, and did not  
18 apply any credibility procedure. AIS applied a common and accepted full credibility standard of  
19 1,084 claims and calculated partial credibility for each coverage using the standard square-root  
20 formula. For the complement of credibility, AIS applied the loss trend from the midpoint of the  
21 latest experience period (accident year 2004) to May 1, 2006.

22 CAARP contended that if it had used a credibility procedure based on CAARP rates for  
23 the complement of credibility, the rate indication would have been much higher. CAARP  
24 commented that using the loss trend assumes that present rates are adequate and disagreed that  
25 this assumption is true.

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27 The Commissioner finds that, while the number of policies in the pilot program is  
28 growing, low cost automobile program data has not yet attained full credibility and the use of a

credibility procedure is appropriate, as provided by statute. Moreover, the Commissioner agrees with AIS that loss trend is a reasonable complement. The single-digit indicated rate increase (after making the changes described in the above sections) before credibility demonstrates that the underlying assumption is sound. Since rate reviews are conducted on an annual basis, the Department has modified the AIS calculation by trending for one year only rather than trending from the latest experience period. Applying the credibility procedure lowers CAARP's overall rate indication by 1.6 percent.

### **ORDER**

For the reasons stated above, it is hereby ORDERED that the statutory rates for the low-cost automobile liability policy be increased to \$355 for Los Angeles County and \$322 for the City and County of San Francisco, and that the current 25 percent surcharge for unmarried male drivers between the ages of 19 and 25 years of age be maintained. It is further ORDERED that the premiums for uninsured motorists bodily injury coverage be increased to \$65 for Los Angeles County and maintained at \$39 for the City and County of San Francisco and that the premiums for medical payments coverage be increased to \$29 and \$26, respectively, for Los Angeles County and the City and County of San Francisco.

Dated: December 8, 2005.

**JOHN GARAMENDI**  
**INSURANCE COMMISSIONER**

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